Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Feedback to consultation on CP74 on competent authority discretions and options in CRDIV and CRR

1. Introduction

Consultation paper CP74 on "*competent authority discretions and options in CRDIV and CRR"* was published on 20th September 2013. The consultation period closed on 1st November 2013 and 2 responses were received by that date.

CP74 outlined the Central Bank of Ireland's (the "Central Bank") proposed approach and perspectives in relation to provisions contained within the Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR), where the competent authority can or must exercise its discretion. CP74 encompassed the competent authority discretions and options that may apply to credit institutions and investment firms (hereinafter referred to as "institutions", except where otherwise specified), as well as those specific to credit institutions or investment firms.

The Central Bank is grateful to those parties who responded to the consultation for their time and effort.

The responses to the consultation are available on our website at the following address: http://www.centralbank.ie/regulation/poldocs/consultation-papers/Pages/closed.aspx?CPNumber=CP74

Having considered the submissions received, the Central Bank has:

- noted the issues which were supported and accepted;
- clarified the key questions raised;
- provided further guidance on its proposed approach, where necessary; and
- revised its current "Implementation of the CRD" Regulatory Document[1].

Institutions should also be cognisant of the potential future implications of the Single Supervisory Mechanism (SSM). The Central Bank will be solely entitled to discharge these competent discretions and options from 1 January 2014 up until the assumption of supervisory responsibilities by the SSM. It is possible that an alternative approach towards the exercise of competent discretions may be pursued in an SSM environment.

[1] http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Documents/Implementation%20of%20the%20Capital%20Requirements%20Directive.pdf

2. Summary

The main issues highlighted by respondents in respect of the proposals set out in CP74 were in the following areas:

i. Scope of Application
ii. Own Funds
iii. Liquidity
iv. Leverage Ratio
v. Credit Risk
vi. Reporting

3. Main issues highlighted

3.1 Level of application of prudential requirements

Article 7 CRR provides the Central Bank with the discretion to waive the prudential requirements for subsidiaries subject to certain conditions. CP74 noted that the Central Bank had not exercised this discretion in the past and does not intend to alter its approach.

Submission

The IBF requested that the Central Bank exercise this discretion in order to ensure a level playing field across Europe, suggesting that a failure to allow such waivers may result in trapped capital in ring fenced mortgage banks and may also have particular implications for such banks in meeting their leverage ratio.

Central Bank

The Central Bank considers that individual level application of own funds and other requirements is the most prudent approach to the management of risk by institutions. It is therefore not altering its approach.

3.2 Own Funds

3.2.1 Pre-approval of capital instruments

As per section 7.7 of CP74, the Central Bank will require all new capital instruments, including any associated arrangements, to have received its prior permission before they may be included in own funds. In cases other than the issuance of ordinary shares, including amendment of the effective terms and conditions of own funds instruments, the Central Bank will require 30 days' notice, starting from the point at which all necessary information has been provided to the Central Bank. "Necessary information" shall comprise a full description of the proposed

issuance. For proposed issuances of CET1, other than common shares, and AT1 instruments, the necessary information shall also be accompanied by a legal confirmation addressed to the Central Bank from an external advisor of sufficient standing and experience in the area of financial services law. That confirmation must unequivocally state that the institution is entitled to recognise the proposed issue within the relevant tier of capital because it and its associated arrangements meet the applicable CRR eligibility criteria. The legal confirmation should take relevant draft and finalised technical standards into account and, in particular, should treat relevant EBA outputs (e.g. Guidelines, Recommendations and Q&A's) as if they were binding.

Submission

The IBF queried whether there will be a new approval process for capital instruments under CRDIV/CRR.

Central Bank

The Central Bank has outlined its approach to pre-approval of capital instruments in section 7.7 of CP74 (as set out above).

3.2.2 Unrealised gains and losses on exposures to central governments

With respect to unrealised gains and losses measured at fair value under Articles 467 and 468, the Central Bank indicated in CP74 that it would permit banks to opt to maintain their filter on both unrealised gains or losses on exposures to central governments classified in the "Available for Sale" category.

Submission

The IBF queried whether it is the Central Bank's intention to extend this derogation beyond the transitional period and sought clarification as to whether the use of the filter is optional by the institution.

Central Bank

The Central Bank will maintain this option for institutions until legislation implementing IFRS 9 has been adopted by the European Commission. The timing of this legislation is unclear and it may occur within, or after, the conclusion of the transitional period. Application of the filter on unrealised gains and losses is optional for institutions. However, once they have elected an approach, they will not be permitted to change without supervisory permission.

3.2.3 Transitional Provision for Own Funds

From 1 January 2015, a competent authority may not set an applicable percentage of unrealised gains under Article 468(2) CRR that exceeds the applicable percentage of unrealised losses as specified under Article 467(2) CRR. By 1 January 2018, according to the CRR, all unrealised

losses and gains must be fully recognised within CET1 (subject to European Commission review).

Submission

The IBF queried whether there was an error relating to the percentages in Articles 467(2) and 462(2) of CP74.

Central Bank

The Central Bank notes that this relates to the precise wording of the level 1 CRR text as published in the Official Journal on 26 June 2013. This requires that an institution cannot have a percentage of unrealised gains removed (rather than "recognised in") from CET1 which is higher than the percentage of unrealised losses recognised in CET1. This has been addressed by a corrigendum amendment to the CRR text. The Central Bank's implementation notice has been amended accordingly with the percentage of unrealised losses to be recognised in CET1 at 40% for 2015.

3.3 Liquidity

3.3.1 Solo waivers

The new liquidity requirements apply on a consolidated and individual basis. A derogation to the application of liquidity requirements on an individual basis can be considered in accordance with Recital 105 and Article 8 CRR. In these cases, the institutions will be supervised at a consolidated or single "liquidity sub-group" basis. Provided the conditions outlined in Article 8(1) CRR are fulfilled, the Central Bank will exercise this discretion on a case-by-case basis. This derogation, which may be a full or partial waiver of the Part Six liquidity requirements, is not related to existing exemptions from the Central Bank's "Requirements for the Management of Liquidity Risk".

Submission

The IBF sought clarification as to why institutions that are already part of a liquidity subgroup would not automatically get a waiver under Article 8.

Central Bank

Article 8 CRR does not provide for an automatic derogation from the application of liquidity requirements on an individual basis. The provision is a competent authority discretion. The article states that "The competent authorities may waive", not "the competent authorities shall waive". For a waiver application to be considered by the competent authorities, the institution and relevant subsidiaries must fulfil all of the conditions specified in points (a) to (d) of Article 8(1) CRR. The competent authorities will assess these applications on a case-by-case basis. In addition, where institutions of the single liquidity sub-group are authorised in several Member States, the relevant competent authorities, when assessing waiver applications, are to come to

an agreement on the elements specified in points (a) to (f) of Article 8(3) CRR, following the joint decision procedure laid down in Article 21 CRR.

3.3.2 Liquidity Reporting

As per the Department of Finance's consultation on *"Member State discretions in the Capital Requirements Regulation and Directive (CRDIV)"*[2], the discretions in Article 152 CRDIV and Article 412(5) CRR have been assigned to the Central Bank. On this basis, the Central Bank confirms that the Central Bank's "Requirements for the Management of Liquidity Risk" will remain in place until 1 January 2018, or an earlier date as may be deemed appropriate by the Central Bank. These national requirements will also continue to apply to Irish branches of credit institutions authorised in another EEA Member State, until the date in 2015 on which the minimum liquidity coverage requirement becomes applicable in accordance with the delegated act adopted pursuant to Article 460 CRR. The Central Bank does not intend to require these branches to submit EBA liquidity reports in accordance with the Implementing Technical Standard (ITS) on Supervisory Reporting[3] during this transitional period.

Article 415(3)(b) CRR contains a discretion for competent authorities to continue to collect information through monitoring tools for existing national liquidity standards until the liquidity coverage requirement is fully introduced in accordance with Article 460 CRR. The Central Bank is exercising the Article 415(3)(b) discretion. Therefore, existing liquidity regulatory reporting will continue until 1 January 2018, or an earlier date, if deemed appropriate by the Central Bank. The reporting process for these submissions will remain unchanged and run concurrently with the new CRR liquidity reporting requirements.

Submission

The IBF contended that the Central Bank's proposed approach would materially increase the reporting burden in an environment where there are already many challenges in meeting CRR/ CRD/ Basel III reporting obligations and they proposed that existing regulatory liquidity requirements be phased out from June 2015, i.e. 6 months post LCR introduction. The IBF also noted that they oppose the potential to accelerate the phase in of the LCR to 100%.

Central Bank

The Central Bank confirms that for 2015 it will not introduce an accelerated phase-in of the minimum liquidity coverage requirement - the minimum requirement will be set at 60% in accordance with Article 460(2) CRR.

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[2] http://www.finance.gov.ie/documents/publications/consult2013/crd4consult.pdf

[3] Final draft EBA ITS: http://www.eba.europa.eu/regulation-and-policy/liquidity-risk/draft-implementing-technical-standards-on-supervisory-reporting-liquidity-coverage-and-stable-funding-

When the Basel III framework was originally published in 2010, a four year observation and transitional period was envisaged. Due to revisions in the Basel liquidity standard and the delay in finalising the CRD IV package, the transitional period for European institutions will now be considerably shorter. At this point in time, the Central Bank considers it prudent to maintain existing national liquidity requirements for an overlapping period to ensure institutions and the Irish financial sector are not exposed to a "cliff effect" with respect to liquidity risk. Should the Central Bank deem it appropriate to review and alter existing regulatory liquidity requirements or the phase-in schedule of the liquidity coverage requirement before 2018, it will engage with institutions on its intentions.

3.3.3 Waiver/derogation application process

From 1 January 2014, a competent authority may grant a derogation on the application of liquidity requirements on an individual basis to an institution where all member institutions of the relevant single liquidity sub-group are authorised by the same competent authority. Where this waiver is granted, the competent authority may also consider waiving the application of all or part of Article 86 of CRD IV on an individual basis. The granting of this waiver of the Part Six CRR liquidity requirements, on a full or partial basis, is subject to the European Commission report outlined in Article 8(1) CRR. This waiver is unrelated to existing exemptions from the Central Bank's "Requirements for the Management of Liquidity Risk".

From 1 January 2015, in accordance with Article 8(3) CRR and subject to the joint decision process outlined in Article 21 CRR, waivers may be considered for institutions where members of the single liquidity sub-group are authorised in several Member States. The granting of this waiver is also subject to the European Commission report outlined in Article 8(1) CRR.

Where a solo waiver to the liquidity requirements is not granted or sought, intra-group liquidity flows and committed facilities may receive preferential inflow and outflow rates, as appropriate, subject to the fulfilment of a set of objective criteria. The Central Bank is proposing to exercise this discretion on a case-by-case basis and subject to the methodology, criteria and parameters to be determined in accordance with the Article 460 CRR European Commission delegated act and the Article 422 and 425 CRR EBA Regulatory Technical Standards (RTSs). For cross-border intra-group liquidity flows, the Article 20 CRR joint decision process will be adhered to.

Submission

IBF suggested early engagement by the Central Bank to clarify the application process and necessary requirements to obtain such waivers/derogations.

Central Bank

The Central Bank issued a letter to Irish licenced credit institutions on 25 November 2013 detailing the application process for new case-by-case waivers/derogations and 'supervisory permissions' arising under CRD IV/CRR which institutions may wish to make use of from 1 January 2014; and which require an application to the Central Bank for consent/approval.

3.4 Leverage Ratio- Individual consolidation method

Article 9 CRR envisages that competent authorities may permit, on a case-by-case basis, parent institutions to incorporate subsidiaries in the calculation of certain of their regulatory requirements under CRR. The Central Bank exercised a similar discretion under Article 70 of Directive 2006/48/EC and proposes to continue with this approach on a case-by-case basis.

Submission

IBF sought clarification as to whether the derogation under Article 9(1) for parent institutions could also be applied to the calculation of the leverage ratio requirement under Article 6.5.

Central Bank

This waiver is not available for the leverage ratio as this ratio does not fall under the scope of Article 6(1). Article 6(5) requires banks to report the ratio on an individual basis unless they already have a derogation under Article 7.

3.5 Credit Risk

3.5.1 Maturity

In the past, the Central Bank required all credit institutions approved to use IRB Models to apply the alternative calculation of maturity to each exposure as specified in Annex VII of Directive 2006/48/EC, Part 2, paragraphs 13-14. Article 162(1) paragraph 2 CRR states that competent authorities may, as part of the permission to use IRB Models, require an institution that has not received permission to use own LGDs and own conversion factors for exposures to corporates, institutions or central governments to use an alternative calculation of maturity (M) for each exposure to that laid down in Article 162(1). For the avoidance of doubt, credit institutions currently approved to use IRB Models should continue to apply the alternative calculation of M for each exposure.

Submission

The IBF noted that Article 162(4) allows banks to consistently set a maturity of 2.5 years on exposures to corporates in the EU with consolidated sales and assets of under €0.5bn. The IBF's interpretation of the CRR suggests that the Central Bank does not have the ability to exercise discretion over Article 162(4) and sought confirmation of this.

Central Bank

As per the text of Article 162(4) CRR, it is a matter for institutions to determine as to whether they wish to set M in accordance with paragraph 1 of Article 162(1) CRR specifically for the types of exposures referenced in Article 162(4) CRR.

3.5.2 Exposures secured by mortgages on immovable property

Unless otherwise decided by competent authorities in accordance with Article 124(2) CRR on financial stability grounds, Article 125 CRR applies a 35 per cent risk weighting to loans fully and completely secured on residential property; subject to fulfilment of certain criteria. Where the relevant criteria are not met, a 100 per cent risk weighting applies.

The Central Bank proposes to avail of the discretion under Article 124(2) CRR to set stricter criteria in this area. Accordingly, the Central Bank proposes to continue to permit a 35 per cent risk weighting for such exposures but only where the loan-to-value (LTV) at market value does not exceed 75 per cent and the residential property is owner-occupied and the other specified conditions are met.

Submission

The IBF raised concerns that there may be an unintended consequence in applying this discretion, in terms of the impact on the NSFR calculation. The IBF suggested applying this discretion for Risk Weighted Assets purposes but not for liquidity purposes on the basis that it could place Irish banks and portfolios at a disadvantage relative to peers in other jurisdictions.

Central Bank

The Central Bank intends to continue to adopt a prudent approach in restricting the 35% risk weight for exposures secured by mortgages on residential property as specified in Article 125 CRR. The CRR does not provide for a separate application of this discretion for stable funding reporting purposes.

3.5.3 Default of an Obligor

Pursuant to Article 178(1)(b) CRR, competent authorities may supplant 90 days with 180 days past due for the purposes of determining default of an obligor with respect to exposures secured by residential or SME commercial real estate in the retail exposure class, as well as in relation to exposures to public sector entities (PSEs).

The Central Bank confirmed in CP74 that it will not be exercising this discretion and considers that 90 days past due is an appropriate backstop definition of default across all exposure classes.

Submission

The IBF noted that there may be an unintended consequence in applying this 90 days past due requirement for credit purposes, specifically impacting the LCR. If a loan is past due, its inflows cannot be included in the LCR. The IBF submission suggested that the application of the 90 day requirement therefore places Irish Banks' LCR at a disadvantage relative to peers in some other jurisdictions.

Central Bank

Liquidity inflows to be reported in accordance with Articles 415 and 425(2) CRR are only to be reported if they are not "past due". The condition of "past due" for liquidity reporting purposes is not linked to the Article 178(1)(b) definition of default.

3.6 FINREP solo reporting

Article 99(3) CRR is a discretion available to the Central Bank to require credit institutions reporting own funds on a consolidated basis in accordance with international accounting standards to also report financial information (FINREP). CP74 proposed that the Central Bank will require all Irish-licensed credit institutions to report financial information in the form of FINREP on a solo basis also.

Submission

The IBF sought clarification of the basis on which FINREP is extended by the Central Bank to all licensed credit institutions, as their interpretation of the discretion is that it extends consolidated FINREP reporting only in certain circumstances (where reporting of own funds on a consolidated basis using IAS has been required under Article 24(2)).

Central Bank

The Draft ITS on Supervisory Reporting clarifies (in the FAQ section[4]) that individual competent authorities may determine the financial information required to be submitted by institutions on a solo basis, including the content of financial information required and the frequency and reporting dates of such information to be applied at a solo level. For a banking group with more than one credit institution in the group that reports on a consolidated basis, a reduced solo version of FINREP will also be required for each credit institution in the group. For a sub-consolidated credit institution that reports on both a consolidated and solo basis, a full consolidated and a reduced solo version of FINREP will also be required for that credit institution. For a credit institution that reports on a solo basis only, a full solo version of FINREP will be required for that credit institution. The Central Bank requires FINREP at a

[4] http://www.eba.europa.eu/documents/10180/359626/EBA+ITS+2013+02+%28Draft+ITS+on+supervisory+reporting%29.pdf/f3e58351-8aec-4827-8e8e-628525122414

solo level under Section 22 of the Central Bank (Supervision and Enforcement) Act 2013.

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